SECOND EDITION

THE 5 MISTAKES EVERY INVESTOR MAKES AND HOW TO AVOID THEM

Getting Investing Right

PETER MALLOUK

WILEY

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Preface

Over my career as a wealth manager, I have met thousands of individuals searching for a better way of investing. I noticed early on that most of the clients coming on board with my firm were terminating a prior advisor. It became clear to me that these clients weren't getting what they had hoped from their former advisors. While at times the issues were related to communication, relationships, and the like, sometimes the change was because the client wasn't getting the returns they had hoped, or their former advisor had blown up their portfolio. Mistakes had been made along the way.

Many investors don't enjoy investing, don't have the time for it, or don't feel they are particularly good at it. This type of investor searches for an advisor to alleviate the burden—to show them the way. Unfortunately, many if not most advisors make the same mistakes individuals often make. This is the tragedy of the financial services industry. As I have watched fortunes made, lost, and sometimes rebuilt again, I have observed the main problems that led to the deterioration of wealth. The conclusion is quite simple: *In most cases, if an investor has greatly underperformed from an investment perspective, it is not because of the markets, but because of their own, or their advisor's own, mistakes*. All of us, at times, are susceptible to at least one of these mistakes. Many of the greatest investors of all time acknowledge they have made them or are aware of them and actively put up mental roadblocks to prevent themselves from making them. For years, I have spoken about these mistakes, and this book will cover how to avoid these pitfalls and show a clear path toward achieving investment success.

Acknowledgments

This book wouldn't be possible without the ongoing efforts of Molly Rothove, Jessica Culpepper, James DeWitt, Brenna Stewart, and Jim Williams, all of whom contributed to this effort as well as to my newsletters, which are the constant source of in-house comedy prior to the editing process.

Special thanks to all of the incredibly talented people at Creative Planning, including those who helped with the research for the behavioral section of this book: Sarah Ayler, Andrew Horsman, Jeff Juday, Ashley Moulis, Meghan Perry, Conner Sivewright, Stacy Smith, and Chris Wolff.

A huge thank you to the clients of Creative Planning. I have learned so much from my clients over the years. Most importantly though, I learned that these are the type of people who make America what it is: the greatest place on earth to live. These folks make the economy go and grow and many of them have lived or are living the American Dream. My constant search for every possible way to help them has resulted in many of the things we do at my firm, and in the contents of this book.

To my mom who tricked me into believing I could do anything. I believed it until I was too old for it to matter. And to my dad, who taught me enough about investing at an early age that it became my passion. I especially cherish his advice to “ignore almost everything.” Thanks to my beautiful wife Veronica, who spent a lot of time driving on our family road trips while I worked on this book, and to my three wonderful kids Michael,[1] JP,[2] and Gabby[3] for always keeping me focused on the most important things in life. Finally, thank you to those who helped edit and shape this book. All errors are my own.

Notes

1 He must have asked half a dozen times: “Is anyone going to read this book?”

2 Thanks for updating me on the NCAA tournament scores while I was writing.

3 Thanks for the hugs, delivered almost every hour on the hour!

About the Author

Peter Mallouk is the president of Creative Planning, named the #1 Independent Financial Advisory Firm in America by *Barron's* (2017). *Barron's* magazine named Peter the #1 Independent Financial Advisor in America three straight years (2013, 2014, and 2015). CNBC named Creative Planning the #1 Independent Wealth Management Firm in the United States (2014–2015). Peter is featured on both rankings of *Worth* magazine's Power 100, a list featuring the 100 most powerful men and women in global finance (2017, 2018). In 2017, Peter was a recipient of the Ernst & Young Central Midwest Entrepreneur of the Year Award. Creative Planning provides comprehensive wealth management services to high-net-worth clients, including investment management, financial planning, charitable planning, retirement plan consulting, tax planning, and estate planning services. Creative Planning currently manages over $70 billion for clients in all fifty states.

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INTRODUCTION
The Market Wants to Be Your Friend

Risk comes from not knowing what you are doing.

—Warren Buffett

You might be wondering why this book appears to be flipping you the bird right out of the box (see Figure I.1).[1] Well, that's the market for you. We often hear about the market averaging around 10 percent over long periods of time. That's true. It just doesn't do it in a nice, linear, stress-free way. It's all over the place. Let's check out the graph in Figure I.2 with the returns by year.

FIGURE I.1

FIGURE I.1

So, yes, it is true the market has averaged about a 10 percent return over the long run. However, most investors never get anywhere near that return out of their stock investments. The reason is that the market return varies. A lot. All the time. To be a successful investor, you need to get comfortable with this concept to avoid the mistakes all investors make or are tempted to make, whether it's market timing, actively trading stocks, falling prey to misleading performance data, behavioral mistakes, or not having a solid, disciplined plan.

So, what keeps investors from earning the market return? Quite simply, investors prevent themselves from participating in the returns the market wants to give them. *Investors go out of their way to make mistakes that keep them from getting the market return*.

Percentage Change in S&P Market Index by Year

					2014					
					2011					
					2007					
					2005					
					1994					
					1993					
					1992					
					1987					
					1984					
					1978					
					1970	2016				
					1960	2012				
					1956	2010				
					1948	2006				
					1947	1986				
					1923	1979				
				2018	1916	1972				
				2015	1912	1971				
				2000	1911	1968				
				1990	1906	1965				
				1981	1902	1964	2019			
				1977	1899	1959	2017			
				1969	1896	1952	2013			
				1962	1895	1949	2009			
				1953	1894	1944	2003			
				1946	1891	1926	1999			
				1940	1889	1921	1998			
				1939	1887	1919	1996			
				1934	1881	1918	1983			
				1932	1877	1905	1982			
			2001	1929	1875	1904	1976			
			1973	1914	1874	1898	1967			
			1966	1913	1872	1897	1963	1997		
			1957	1903	1871	1892	1961	1995		
			1941	1890	1870	1886	1951	1991		
			1920	1887	1869	1878	1943	1989		
			1917	1883	1868	1864	1942	1985		
			1910	1882	1867	1858	1925	1980		
			1893	1876	1866	1855	1924	1975		
			1884	1861	1865	1850	1922	1955		
			1873	1860	1859	1849	1915	1950		
		2002	1854	1853	1856	1848	1909	1945		
		1974	1841	1851	1844	1847	1901	1938	1958	1954
		1930	1837	1845	1842	1838	1900	1936	1935	1933
		1907	1831	1835	1840	1834	1880	1927	1928	1885
	2008	1857	1828	1833	1836	1832	1852	1908	1963	1879
1931	1937	1839	1825	1827	1826	1829	1846	1830	1943	1862
–50	–40	–30	–20	–10	0–10	20	30	40	50	60

FIGURE I.2

The first step to moving forward is to rid yourself of the misconceptions you may have about what works and become aware of the most common mistakes and avoid them. That's what this book is about. Recognizing the mistakes to avoid can dramatically improve your investment performance, reduce your stress level, substantially increase the probability you will achieve your investment goals, and even improve the quality of your life.

Let's begin.

Note

1 "Flipping the bird," otherwise known as "flipping you off" and a variety of other things, is a decidedly PG-13 concept. I am assuming you are 13 or that someone older than 17 gave you the book, and that this is not a concept you have never heard before or that you will take too much offense to. Besides, I'm not really flipping you the bird; the market is. I can't control that.

MISTAKE #1
Market Timing

Boy, do I have an investment for you! It has earned about 10 percent per year over the last 88 years and has gone straight up. Check it out (see Figure 1.1)!

Now, what if I told you that return was real? More intriguing is that it is readily available to you. It's just waiting for you to participate. What is this incredible, magical investment? Well, it's something you may have heard of: the stock market.

If you are like most Americans, this sort of return seems like a dream. Numerous studies attempt to quantify the returns realized by individual investors relative to the market as a whole, and their conclusions are the same: Investors' stock portfolio returns regularly lag behind the stock market return and typically by a very wide margin. Market timing is the idea that there are times to be in the market and times to be out of it. Some people attempt to “protect” their money by exiting the market when they sense a downturn coming or load up on high-risk stocks when they anticipate a recovery.

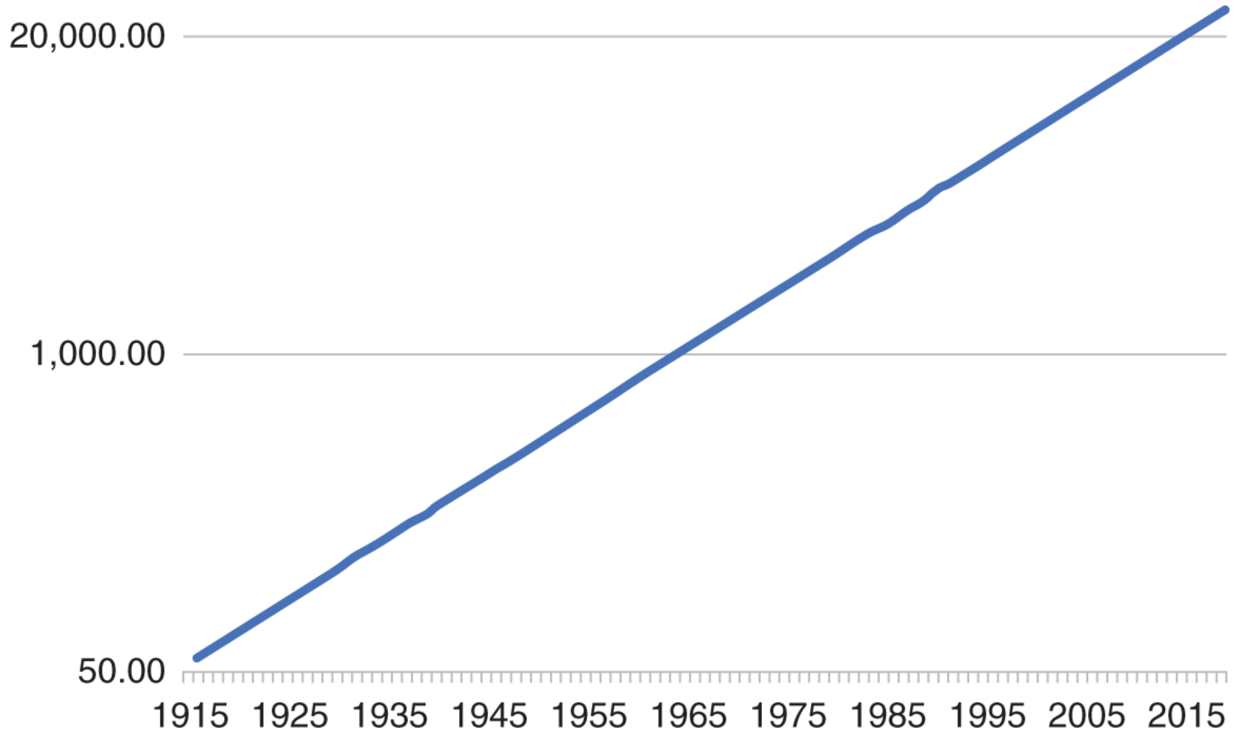

FIGURE 1.1

Source: Data from S&P Dow Jones Indices, LLC 2014.

Let's get one thing straight right out of the box. Market timing doesn't work. It just doesn't. And don't tell me you don't market time either. Have you ever said or thought anything like this:

> “I have cash on the sidelines, and I am just waiting for things to settle down.”
>
> “I have a bonus, but I'll wait for a pullback.”
>
> “I'll invest after [insert lame excuse here; some choices: the election, the new year, the market corrects, the debt crisis passes, Congress works out the budget, the Lions win the Super Bowl, or whatever].”

All of that is market timing.

Why would anyone want to get in the way of an investment that has perpetually produced such fantastical[1] returns?

Quite simply, it is because the stock market doesn't go up in a straight line. Drawn as the returns actually happened, the graph looks like the one shown in Figure 1.2.

That still doesn't look so bad when we look at it from here, with the full benefit of hindsight. Of course, living through it is an entirely different matter. Imagine the emotional turmoil you would have gone through during the Great Depression, the feeling of inertia and futility you would have had to endure through the 1970s, or the market panic during the early part of 2020 (actually, you likely don't need to imagine that one!). With investing, even a few weeks can seem like forever, especially when the market is moving against you.

To be clear, there are many "markets." The graphs we have looked at so far represent the Dow Jones Industrial Average, an index of 30 large U.S. companies with a history allowing us to go back more than 100 years. Today, the more common index is the S&P 500, an index of 500 large U.S. companies, like Microsoft, ExxonMobil, Google, Procter & Gamble, and Apple. While there are thousands of stocks, the largest 500 make up about 80 percent of the entire market. This is because companies like McDonald's, in the S&P 500, are hundreds of times larger than, say, the Cheesecake Factory.[2]